BIPAR RESPONSE

ESMA Consultation paper on Technical Advice on integrating sustainability risks and factors in MiFID II

19 February 2019

BIPAR Register ID number: 58041461167-22

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BIPAR is the European Federation of Insurance Intermediaries. It groups 52 national associations in 30 countries. Through its national associations, BIPAR represents the interests of insurance agents and brokers and financial intermediaries in Europe.

Besides some large multinationals, the insurance intermediation sector is composed of hundreds of thousands of SMEs and micro-type operators. It accounts for 0.7% of European GDP, and over one million people are active in the sector. Insurance and financial intermediaries facilitate the insurance and financial process for several hundreds of millions of customers. The variety of business models, the high level of competition and the geographical spread in the sector ensure that everyone in Europe has easy access to tailor-made insurance and financial services.

BIPAR is a member of the World Federation of Insurance Intermediaries (WFII).
BIPAR supports the Commission’s and ESMA’s ambition to encourage investments in a more sustainable world. Insurance and financial intermediaries play an important role in helping investors achieve their goals and objectives – both financial and non-financial – as well as in contributing to economic growth through signposting products promoting efficient allocation of capital.

We recognize the need for a concise framework on transparency of sustainability risks and factors towards consumers in order to build public trust and avoid miss-selling. We agree that integrating ESG consideration into investment advice and creating a new framework for sustainable finance are necessary to channel investments into sustainable activities and strengthen financial stability.

In this context, it is important to ensure that the various legislative initiatives do not trigger duplication of requirements for insurance intermediaries and financial advisors but establish a consistent framework.

BIPAR also believes that there are also other ways to promote sustainable products and incentivize transitioning to a green economy - such as tax incentives that could encourage investment into sustainable economic activities. More regulation and more information should not be the sole solution.

Questions

Q1: Do you agree with the suggested approach and the changes to the Article 21 of the MiFID II Delegated Regulation on ‘general organisational requirements’? Please state the reasons for your answer.

BIPAR endorses the high-level principle-based approach followed by ESMA in relation to the integration of sustainability risks and factors into the MiFID II provisions, similar to that already followed for all other relevant risks (e.g. credit risk, market risk, liquidity risk).

BIPAR agrees that, considering that several Commission legislative proposals are still ongoing – proposal for a Regulation on the establishment of taxonomy, proposal for a Regulation on disclosures relating to sustainable investment and sustainability risks, too prescriptive requirements in relation to sustainability risks may result in potential regulatory inconsistencies and subsequently in legal uncertainty for both intermediaries and their clients.

BIPAR is pleased to note that ESMA approach is consistent with the approach followed by EIOPA in its draft technical advice on the integration of sustainability risks and factors under the IDD.

BIPAR supports the suggested approach and the changes in Article 21 of the MiFID II Delegated Regulation. Sustainability considerations should be taken into account in the investment and advisory process only subject to the fact that they are relevant, in the sense that the clients have expressed preference in attaining ESG objectives.

Q2: Do you agree with the suggested approach and the changes to the Article 23 of the MiFID II Delegated Regulation on ‘risk management’? Please state the reasons for your answer.

BIPAR agrees with the suggested approach in Article 23 of the MiFID II Delegated Regulation to ensure that ESG considerations are taken into account in the risk management policies and procedures.

In this context, BIPAR notes that these additional requirements related to sustainability consideration should apply in accordance with the proportionality principle. In other words, when identifying the
risks related to their activities, investments firms should take into account the size, nature, scale and complexity of such activities.

Furthermore, it is important to highlight that there is **lack of clarity as to what is meant by the term ESG factors**. Investment firms need to have a clear and consistent understanding of what investments are considered sustainable, including all three ESG aspects. A well-built taxonomy is therefore necessary before investments firms are obliged to take into account ESG risks and factors in their risk management policies and organisational procedures. This Consultation Paper seems to assume that there is a common understanding as to what ESG means which we believe does not reflect the current situation neither amongst investment firms, nor amongst clients and potential clients.

In this light, we have a specific comment on paragraph 9: our understanding is that the taxonomy will not cover company shares traded on regulated markets. It would be, hence, helpful if ESMA could explain how it expects firms to address ESG issues in the context of company shares.

**Q3: Do you agree with the suggested approach and the new recital on ‘conflicts of interest’? Please state the reasons for your answer. What would be specific examples of conflicts of interests that might arise in relation to sustainability considerations?**

The conflict of interests that may arise when investment firms provide advice on financial products with ESG objectives are the same that could arise when advice is provided on products without ESG objectives. **The existing rules on conflict of interests as laid down in the MiFID II Delegated Regulation adequately cover every situation of conflicts-of-interests that may arise and they should also apply to the advice of sustainable products.** BIPAR sees therefore no cases related to ESG objectives which would – a priori- require different treatment than cases where no ESG objectives exist.

BIPAR sees **no need for changes or introduction of additional rules** in the existing rules on conflicts of interest. BIPAR endorses therefore the **high-level principle-based approach** followed by ESMA in relation to the integration of sustainability risks into the MiFID II provisions, particularly the conflicts of interest requirements.

BIPAR understands that by introducing recital 59 (bis) in its draft technical advice, ESMA aims to clarify that when identifying the conflicts of interests that may damage the interests of a client, investment firms should also take into account non-financial interests linked to ESG preferences, if any.

BIPAR suggests introducing the wording “**where relevant**” in recital 59 (bis) of the MiFID II Delegated Regulation. This way, the ESMA technical advice will be consistent with the direction taken by the Commission in the Draft Amendments to the MiFID II Delegated Regulation “as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice and portfolio management”.

**Recital 59 (bis) of the MiFID II Delegated Regulation should read as follows:**

> “When identifying the types of conflicts of interest whose existence may damage the interests of a client, investment firms should include those that may stem from the distribution of environmentally sustainable investments, social investments or good governance investments, where relevant.”

This is considered a good means to clarify that sustainability risks and factors should be taken into account without outweighing other risks. This means that only in the case that clients have any ESG preferences and have raised them either proactively or after having been asked specific questions,
intermediaries will be required to take into account sustainability considerations in a way proportionate to the other interests to be taken into account.

Q4: Do you think that on the topic of ‘organisational requirements’ other amendments should be made to the MiFID II Delegated Regulation in order to incorporate sustainability risks and factors? If yes, which ones? Please state the reasons for your answer.

As already mentioned, BIPAR supports the amendments proposed in the ESMA draft technical advice and endorses the high-level principle-based principle followed by ESMA. Considering that several Commission legislative proposals are still ongoing – proposal for a Regulation on the establishment of taxonomy, proposal for a Regulation on disclosures relating to sustainable investment and sustainability risks, BIPAR believes that at this stage there is no need for further amendments to the MiFID II Delegated Regulation.

At this point, BIPAR would like to draw the attention of ESMA to the fact that, given the way the ESG considerations are being introduced in the investment and advisory process across sectors, duplications of requirements may arise from potential overlaps between the general rules imposing on financial market participants, insurance intermediaries and financial advisors disclosure requirements related to sustainability risks (lex generalis) and the sector-specific rules specifying such requirements for financial advisors under the framework of MiFID II (lex specialis).

Q5: Which existing market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe.

Despite the willingness of our sector to promote investment in sustainable assets, BIPAR notices lack of offer of products labelled as targeting ESG objectives.

Having in mind the need for very clear and precise definitions of target market, BIPAR believes that relying on current market standards and labels is not a satisfactory approach.

Furthermore, it is important to highlight once again that there is lack of clarity as to what is meant by the term ESG preferences/objectives. Financial intermediaries need to have a clear, consistent and common understanding of what investments are considered sustainable, including all three ESG aspects. A well-built taxonomy is therefore necessary before distributors are obliged to take into account ESG risks and factors and provide to their clients advice on products marketed as targeting ESG objectives. This Consultation Paper seems to assume that there is a common understanding as to what ESG means which we believe does not reflect the current situation neither amongst investment firms, nor amongst clients and potential clients.

In this context, we would like to point out that potential investors may express ESG preferences, not only because they are concerned about environmental and social problems, but for a variety of reasons. Some ESG investment approaches, for instance, achieve much better returns over 3/5/7-year periods, or are good for risk mitigation; any ESG benefits are incidental. BIPAR calls for a broader approach which will allow acknowledging that ESG strategies can be desired by investors for their impact on returns (and risk). Any principles or guidance should adopt a more balanced approach and highlight that there are other reasons for pursuing ESG investments.
Q6: Do you agree with the suggested approach and the proposed amendments to the MiFID II Delegated Directive Articles on 'product governance'? If not, please explain.

Sustainability considerations should **only be included in the target market assessment with respect to financial products addressed to clients with ESG preferences.**

The introduction of the wording **“where relevant”** in the relevant articles of the MiFID II Delegated Regulation, as proposed by ESMA, is considered a good means to clarify that financial distributors will be required to consider ESG factors in the product oversight and governance process, **only when the product in question is marketed as having an ESG profile and potential clients have expressed ESG preferences.**

BIPAR therefore suggests introducing the wording **“if any”** in addition to **“where relevant”** in the relevant articles of the proposal amending the MiFID II Delegated Regulation, in order to be consistent with the Commission proposal amending the MiFID II Delegated Regulation as published in January 2019.

Article 9(9) of the amended MiFID II Delegated Regulation should read as follows:

“**Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, including (where relevant) ESG preferences, if any, the financial instrument is compatible.** As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified.”

Article 9(14) of the amended MiFID II Delegated Regulation should read as follows:

“**Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider if the financial instrument remains consistent with the needs, characteristics and objectives, including (where relevant) ESG preferences, if any, of the target market and if it is being distributed to the target market, or is reaching clients for whose needs, characteristics and objectives the financial instrument is not compatible.**”

Article 10(2) of the amended MiFID II Delegated Regulation should read as follows:

“**Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives, including (where relevant) ESG preferences, if any, of an identified target market and that the intended distribution strategy is consistent with the identified target market.**”

Article 10(5) of the amended MiFID II Delegated Regulation should read as follows:

“**Member States shall require investment firms to review the investment products they offer or recommend and the services they provide on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives, including (where relevant) ESG preferences, if any, of the identified target market and whether the intended distribution strategy remains appropriate. [...]”**

This amendment aims to make clear that only in the case that **clients have any ESG preferences and have raised them either proactively or after having been asked specific questions,** financial distributors will be required to take into account sustainability considerations in a **way proportionate to the other interests** to be taken into account.
Furthermore, BIPAR notes the will to introduce sustainability considerations in the investment value chain as a whole. However, considering that the classification criteria specifying what is sustainable are still under examination and the supply of new sustainable products is still low, BIPAR calls for a reasonable approach in order to achieve optimal sequencing between the relevant legislative initiatives. The market needs more time to react to the new “sustainability reality” and address the public’s needs in a stable and efficient way.

**A first priority should be to define what is sustainable.** Only then, distributors are obliged to take into account non-financial considerations and to provide advice on sustainable products to their clients.

Secondly, manufacturers of the product promoted/qualified as targeting ESG preferences should be the ones responsible to label the product and subsequently the ones to comply with the ESG disclosure obligations. Only then, the legislation imposing obligation to take into consideration (where relevant) sustainability factors into the investment advice can be triggered. In the interest of clarity, labelling should be as standardised as possible.

**This sequencing should be reflected in the application date of various legal acts.** BIPAR believes that ESMA should include in its technical advice a reference to the application date.

**Q7: Do you agree with the proposed changes to the ESMA Guidelines on MiFID II product governance requirements and the addition of an additional case study? If not, please explain what changes should be made and why.**

As already mentioned, BIPAR supports the amendments proposed in the ESMA draft technical advice and endorses the high-level principle-based principle followed by ESMA. BIPAR suggests introducing the wording “if any” in addition to “where relevant”, for the reasons explained above under Q6.

Paragraph 8 of the ESMA Guidelines on MiFID II Product Governance Requirements should read as follows:

“The firm should specify the investment objectives and needs of target clients that a product is designed to meet including client (where relevant) ESG preferences of the client, if any, and the wider financial goals of target clients or the overall strategy they follow when investing.”

ESG objectives should be considered in the description of the target market only if the product is designed for clients with ESG preferences. Specifying in a positive way that a product is compatible for clients with ESG objectives would be helpful for distributors to recommend products that best suit their clients’ needs.

BPAR believes that introducing a requirement to state in a negative way that particular investment/insurance products do not pursue ESG objectives is not appropriate. This is for various reasons: 1) the concept of sustainability is still evolving, 2) no studies on behavioural economics have been carried out to measure the impact of such an explicit negative statement on potential investors. It could be that consumers would automatically consider how they would appear in the eyes of the provider/distributor (and others) and have the belief that they would be held in a lower regard if they do not choose sustainable products, so would feel pressured to opt for a product with ESG profile. Consumers should experience no pressure to choose financial products with ESG objectives. Leading people into making choices that contribute to ESG factors may be a good thing, but that is a separate sentiment to obtaining a person’s genuine investment objectives. This is to be seen in relation to the fact that consumers often ask for a mixed portfolio composed of both sustainable products and traditional products. This is not a black or white story and we believe that a negative statement would not suit at this moment the interests of clients.
We would also refer you to our response to Q5 which should be addressed in revised Guidelines. The feedback from our member associations points to the issue of availability of such products in the market.

**Q8: Do you think extra guidance is needed on the elements listed in paragraph 15 above? If yes, please provide details.**

BIPAR believes that a further case study where the product risk level is high would be helpful to illustrate the interaction between the overriding obligation to meet suitability obligations and the obligation to take into account the client’s ESG preferences.

**Q9: Please specify any approach you see to identify environmental, social and governance criteria separately from each other or as a single indicator. Please explain how the criteria would interact with each other and how the target market assessment and matching would be performed in such cases.**

Considering that the work on taxonomy is still ongoing, investment firms are still seeking to understand their obligations and are not yet in a position to specifically state whether they would assess environmental, social and governance criteria separately from each other or as a whole. BIPAR has received no detailed comments from its member-associations on the approach to be followed regarding this issue.

BIPAR stresses out however that it is very important to ensure a common approach for manufacturers and distributors.

**Suitability**

**Q10: What current market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe.**

Please see our response under Q5.

**Q11: Do you agree with the suggested approach and the amendments to paragraph 28 of the suitability guidelines? If not, do you have any suggestions for developing a more detailed approach with regard to (a) the collection of information from clients and (b) the assessment of ESG preferences with the assessment of suitability?**

**Q13: Do you agree with the suggested approach and the amendments to paragraph 70 of the suitability guidelines?**

BIPAR supports the ESMA proposal to integrate ESG considerations in the Guidelines on suitability as part of the advisory process and product classification. As already mentioned, BIPAR endorses the high-level principle-based principle followed by ESMA leaving thereby sufficient flexibility for implementation by firms. BIPAR agrees with ESMA on that “firms should decide how to best incorporate clients’ ESG preferences within their existing suitability processes”.


BIPAR further agrees that **sustainability considerations should not outweigh the relevance of the other suitability criteria** (knowledge and experience, financial situation and financial investment objectives) and relevant risk factors (such as credit risk, market risk, liquidity risk) in a way that might not result in the client’s best interest. The guidelines should therefore explicitly state that ESG considerations are to be seen only as an additional aspect to the other suitability criteria used to ascertain whether or not a given product is suitable for a client. This means that, once more than one product have been identified as suitable following the current suitability assessment, the product that fulfils best the client’s ESG preferences should be chosen at a second stage.

In this context, BIPAR wishes to point out that, considering that the new ESG obligations on advice and disclosure will start to apply before the EU taxonomy (specifying common criteria on what is sustainable) is established, providers and distributors would have to develop their own criteria and processes to comply with these ESG obligations. Following the adoption of the taxonomy, they would have to develop once more new processes in order to comply with the new criteria framework.

This may lead to **considerable liability risks**. In other words, once EU taxonomy is available, clients might challenge these ESG criteria developed individually by companies giving grounds for **mis-selling cases**. This is to be seen in relation to the fact that due to rapid technological and scientific developments, the concept of “sustainability” changes swiftly. What is considered sustainable today may not be sustainable tomorrow!

**Q12:** Please specify any approach you see to assess environmental, social and governance criteria separately from each other or as single preferences. Please explain how the criteria would interact with each other and how the suitability assessment would be performed in such cases.

Please see our response under Q5.

**Q14:** What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk-management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

It is difficult to estimate in advance the exact costs that the sustainability-related changes in the MiFID II may bring about to financial intermediaries. Feedback from our member-associations suggests that the costs will be mainly related to:

- Staff training or recruitment of specialists;
- Amendments to IT systems capturing client information;
- Access to additional (sustainability) data;
- Revision of management information and portfolio monitoring systems;
- Revising product governance procedures to take account of ESG preferences; and
- Establishing contact with existing clients to ascertain ESG preferences.

Further to **implementation costs**, BIPAR also expects additional costs to arise from reporting requirements to prove compliance with the amended rules on investment advice to integrate ESG preferences and with the new rules on ESG disclosure duties.

BIPAR warns that such costs should be taken into account when introducing new obligations, as it is most likely that the consumers will have to ultimately bear them. For instance, considering that the new ESG obligations on advice and disclosure will start to apply before the EU taxonomy (specifying
common criteria on what is sustainable) is established, **unnecessary costs** will arise as providers and distributors would have to develop their own criteria and processes to comply with these ESG obligations. Following the adoption of the taxonomy, they would have to develop once more new processes in order to comply with the new criteria framework.

In addition, considerable **liability risks** may arise for distributors and providers if they are obliged to develop their own ESG criteria ahead of the agreement on an EU taxonomy. In other words, once EU taxonomy is available, clients might challenge these ESG criteria developed individually by companies giving grounds for **mis-selling cases**.